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1120 Connecticut Avenue, NW
Washington, DC 20036

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Rodrigo J. Alba
Vice President,
Mortgage Finance &
Senior Regulatory
Counsel
Phone: (202) 663-5592
Fax: (202) 828-5043
ralba@aba.com

December 23, 2009

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington D.C. 20551

Re: Docket No. R-1366
Regulation Z, Truth in Lending, Proposed Rule

Dear Ms. Johnson:

The American Bankers Association (ABA)[1] is pleased to provide our comments on the Federal Reserve Board's (Board) proposed changes to amend Regulation Z. The Federal Reserve Board is issuing proposals to amend Regulation Z as part of a comprehensive review of TILA's rules for closed- and open-end credit. The Board is proposing changes to the four principal types of credit disclosures governed by Regulation Z: (1) disclosures at application; (2) disclosures within three days after application; (3) disclosures three days before consummation; and (4) disclosures after consummation. In addition, staff recommends additional consumer protections related to loan originator compensation.

These comments will cover the closed-end credit proposals for loans secured by real property or a consumer's dwelling. ABA generally appreciates and supports the Federal Reserve Board's efforts to improve the disclosures and help to ensure that mortgage disclosures are relevant and understandable to consumers. ABA comments are set forth below:

Disclosures at Application

Key Questions Disclosure:

The Board is proposing new format and content requirements for disclosures given at application to make them more meaningful and easier for consumers to use. Among the proposed changes, the Board would require the provision of a new one-page Board publication, entitled "Key Questions to Ask about Your Mortgage," (Key Questions)which explains potentially risky features of a loan.

[1] The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

ABA concurs with the Board on the need to ensure that consumers are well educated about risks and benefits in mortgage finance transactions. We also commend the Board for proposing a document that is designed on the basis of actual consumer testing and format preferences (question-and-answer tabular format). Our comments on this item focus almost entirely on the proposed regulatory formula to trigger the delivery of these disclosures.

Under the proposed rule, creditors would be required to provide the Key Questions for all closed-end loans secured by real property or a dwelling, not just variable-rate loans, before the consumer applies for a loan or pays a nonrefundable fee, whichever is earlier.

The first concern regarding this provision is that the timing for delivery is open-ended and is certain to lead to over-distributions of this early disclosure. Prudent banks will seek to achieve precise compliance with this provision through standards and processes that can be uniformly applied. If finalized as written, this proposed provision will necessitate a system of guidelines under which the loan officer will become obligated to deliver the "Key Questions" disclosure every time a consumer asks about applicable mortgage rates, or comments about the possibility of purchasing a home, based on a reasonable probability that this consumer may submit an application.

The prospect of disclosure overkill is supported by feedback from members, where our banks report that consumers are increasingly relying on the Internet medium to shop for best terms and interest rates. Various independent reports support this trend towards online shopping, where consumers rely on the product research via Internet to gain confidence about their product and service purchases. Members also report a large incidence of consumer shopping via telephonic inquiries, where potential borrowers actively amass information from numerous lenders before explicitly asking any one specific loan provider to proceed with an actual "application."

These concerns must also be viewed from the consumers' perspectives. A very likely result in the application of this rule is that any consumer actively shopping the loan market will, under the proposed formulation, be inundated with multiple copies of these early disclosure forms. This is likely to lead to pointless deliveries of these disclosures to all "window-shopping" consumers; the disclosure overload is likely to cause the public to disregard these forms altogether.

ABA also harbors reservations about how this disclosure will be implemented to avoid enforcement and examination difficulties. In short, banks will have to incorporate actual evidence of this "disclosure delivery" into their systems in a way that it is accurately verified and confirmed for purposes of regulatory examinations. This creates a situation where the consumer will be positively required to sign a form, or give some other sufficient indication of receipt, that will allow loan officers to certify that the disclosure was delivered. When combined with the "over-distribution" effect described above, this additional signature or certification requirement will surely lead to customer annoyance and irritation. Worse, it will also lead to consumer perceptions that the originator is overreaching, and rushing the customer to sign papers at the "window-shopping stage" of the process. This is not an ideal outcome in any way, and our members would like to avoid being placed in such a situation.

In summary, there are market realities that compel that the Board fine-tune this proposal to avoid pointless deliveries of disclosures to mere "window-shoppers." Different creditors often have varying levels of communication with their customers before they reach the "application" trigger point. In addition, different creditors use varying media to communicate marketing, shopping, and application information to the shopping public. ABA therefore requests a more defined timing trigger for the duty deliver this disclosure—the proposed trigger based on a duty to act at some point "prior" to a general occurrence, as set forth in this proposal, is inherently murky, and will result in great confusion in the application of the provisions in terms of enforcement and compliance efforts.

ABA Recommendations:

ABA believes that the difficulties identified above, and the timing for this disclosure, could be resolved without diminishing the benefits of this disclosure if the delivery were required simply "at application." This alternative trigger would greatly simplify the implementation of this requirement into our members' systems, and would afford a clarity that allows it to be better integrated into all other new regulatory requirements that banks are currently confronting.

We note that our alternative does not in any way compromise timely delivery of consumer information. If the Board's proposed disclosure is simply required at application, there would be a built-in guarantee that the consumer has not fully committed to the lender, and can continue to consider other market offers with no economic loss. Also, this formulation better adapts to Congressional design because it melds the proposed "Key Questions" form into the recent MDIA rules that place prohibitions against charging of fees prior to delivery of the early TIL disclosures. As discussed elsewhere in these comments, RESPA rules have also been fairly well harmonized with MDIA/TILA in this respect, so regulatory clarity would be mostly met across all applicable regulatory provisions, without reducing consumer benefit.

In short, the Board should simply allow this form to be part of the application disclosures, thereby allowing lenders to more effective adequately ensure compliance with all applicable regulatory requirements. On the Internet setting, this disclosure would be generated for the consumer at the point where they express a willingness to complete the application form online.

We offer another option that would be as effective, especially in light of the recent protective provisions brought about by the MDIA changes. The Board should consider the alternative of allowing creditors to provide this notice along with the three-day (early) disclosures provided under TILA and RESPA. This approach affords the lender with the timing clarity they require, and allows consumers to have full access to this disclosure at a timely point in the application process. Since, as the MDIA changes now impose, the consumer has not committed to either terms or significant fees, there is adequate opportunity for the consumer to read and understand this disclosure without possibility of abusive practices.

Finally, ABA requests that the Board clarify that mortgage brokers can provide the "Key Questions" disclosure, and that in brokered loans, the lenders should not be held liable for regulatory failures concerning this form. In analyzing this recommendation, the Board must keep in mind that, in brokered transactions, the broker is the party that deals with the consumer at the shopping and application stage, where this document has most effect. They should, therefore, be solely responsible for any regulatory violation for timely delivery or compliance obligation for demonstrating such timely delivery.

"Fixed vs. Adjustable" Disclosure:

The Board is proposing a new one-page Board publication, entitled "Fixed vs. Adjustable Rate Mortgages," which explains the basic differences between these loan types. This disclosure would replace the current *Consumer Handbook on Adjustable-Rate Mortgages* (CHARM booklet) and would apply to all closed-end loans secured by real property or a dwelling (not just variable rate loans).

ABA generally agrees with the need to update existing disclosures that are provided to consumers regarding adjustable-rate mortgages. As an initial and general point, ABA reminds the Board that these amendments will require programming changes to accurately accommodate any form changes, and would therefore request reasonable lead times to do so. Moreover, the Board should not abridge the flexibility under the regulations that allow lenders to disclose loan features accurately, including the ability to make changes or additions to the proposed forms.

Most importantly, in the spirit of encouraging that consumers become more educated about mortgage loans, ABA has some concerns about the proposed contents of this publication. First, it may be sensible to use this early disclosure mechanism to provide a description of risks in all variable loans generally. For example, certain loans have stepped-up rates or increasing payments; others offer a fixed rate, but provide options to pay interest only; still others have negatively amortizing payment schedules. It is not clear why the Board would select only ARM products as those that alone warrant expanded consumer disclosures.

ABA's concerns with the proposed disclosures therefore center on the fact that they do not set forth a full and objective description of the mix of choices and consumer risks and benefits that ARM products provide. ABA does not necessarily disapprove of the articulation of the proposed disclosures; rather, it is the Board's exclusive focus on ARMs as a class, and the fact that it identifies only negative consequences of such products, that ABA believes result in the "singling out" of ARMs as especially pernicious products. We do not have to point out, however, that ARM transactions have very potent advantages that offer consumers great benefits. Both "good" and "bad" must be reflected in any disclosure that seeks to properly inform credit shoppers.

Our banks are sensitive to this point because we believe that official government forms and descriptions are more noticeable than other disclosures provided to a consumer. An official government form that points only to harm will entirely trump a lender disclosure that sets forth descriptions of the advantages of a given product. In instances of adjustable rate products, the advantages can be numerous.

As examples, although monthly payments can indeed increase in ARM products, these products have real consumer advantages in periods of high interest rates and when rates fall. Also, statistics confirm that average American families relocate every five to seven years. They can therefore sometimes save hundreds of dollars per month, or invest that money elsewhere, while still enjoying their own home. Without mentioning the full list of potential advantages, these positive countervailing considerations are not explained or mentioned in the proposed disclosures, therefore resulting in a rather biased description of potentially good products.

We note that countless community banks across the United States offer conservative and safe ARM products; these products cannot be grouped into the same categories of predatory and high-risk products that were offered during the "subprime boom." The language in this consumer handbook, however, does not clearly present the differences between high-risk ARM products and low-risk ARM products.

ABA Recommendations:

We recommend that the Board offer fuller and more objective explanations concerning ARM products. In particular, the Board should state that these products can offer substantial savings to consumers in the initial phase of the loan, and that can be used as valuable financing tools in individual circumstances.

<u>Disclosures within Three Days after Application</u>

The Board is proposing revisions to TILA disclosures provided within three days after application in order to make the information "clearer and more conspicuous." The proposed changes include revisions to 226.19(a)-(b) so that the early disclosures currently required for closed end transactions secured by a dwelling and subject to RESPA are more generally applicable to all closed-end transactions secured by real property or a dwelling. (Section 226.19). The proposed § 226.19(a) would therefore apply to transactions secured by real property that does not include a dwelling, such as vacant land, and transactions that are not subject to RESPA, such as construction loans. The Board makes additional technical amendments are made to § 226.19 in order conform certain timing "presumptions" that were part of the MDIA rulemaking.

ABA Comments:

These proposed amendments reflect the very close interconnectedness of the current proposed rules and the efforts by HUD to reform Regulation X. We describe the RESPA-TILA difficulties in more detail below, but take this opportunity to persevere in our requests that the Board redouble its efforts to synchronize this rule with Regulation X requirements in a way that is clear, transparent, and free of regulatory traps. The massive regulatory changes occurring today are creating vast confusion in our industry, and piling on extremely high compliance costs. Notwithstanding the Board's most sincere efforts to clarify Regulation Z, these closed-end rules will never be entirely coherent until they are properly fused with related provisions under Regulation X. We again urge that the two agencies come together to achieve much needed coordination in the law.

The ABA offers the following comments on the Board's proposals to clarify early disclosures--

- Proposed Definition of Application: The determination of what constitutes an "application" is a particularly thorny issue due to the complexity of the differing regulatory provisions that currently pertain to "applications" in mortgage lending. Under the proposed rule, Comment 19(a)(1)(i)-2 provides that creditors may, in determining whether an application has been received, rely on RESPA and Regulation X even for a transaction not subject to RESPA. ABA recommends that this comment be further revised to state that for such transactions, creditors may also determine whether an application has been received by relying on ECOA and Regulation B. This would have no significant effect on consumers, yet would increase regulatory clarity and allow creditors to better manage the tangled web of definitions that exist for this term.

- Definition of "Business Day": ABA requests that the Board consider refining the rules that define "business day." We recommend that creditors be deemed to have delivered the early TILA disclosure on a timely basis if the early TILA disclosure is mailed or delivered within either three "precise" business days <u>or</u> three "general" business days. Both the current regulation and the proposal require that early TILA disclosures be mailed or delivered within three "general" business days after application. "Precise" business days are defined as all calendar days except Sundays and the legal holidays specified in 5 U.S.C. § 6103(a). "General" business days are defined as days that "the creditor's offices are open to the public for carrying on substantially all of its business functions." In most instances, banks will have diminished staff and resources on Sundays and legal holidays, and would therefore have difficulty preparing disclosures on those days. However, because the public may be able to contact the creditor on those days, the current rule creates uncertainty as to whether the creditor is "open." Allowing the creditor to use the precise definition would eliminate this uncertainty.

- Clarification on Revised TILA Disclosure: Under recently finalized RESPA rule (and implementing FAQs), HUD indicates that a GFE may not increase the estimates for settlement charges from what was provided on the initial GFE unless such modifications are justified by "changed circumstances" or borrower-requested changes. This is the case even if the creditor subsequently obtains information showing that the fee is higher than initially estimated and disclosed. Assume, for example, that fees subject to HUD's 10% tolerance were initially estimated at $2,000 and are now estimated at $2,100, and further, assume that the changed circumstances do not justify an increase in those costs. Because the comparison of GFE fees to actual fees on page 3 of the HUD-1 bases the tolerance calculation on the amounts disclosed on the GFE, the amount disclosed on the revised GFE should continue to be $2,000, so that borrower can see that the actual charge of $2,100 is within tolerance.

  We request a clarification to Comment 226.17(c)(2)(i)-1 stating that the creditor may estimate the amounts of fees using either (i) amount of the fees based upon information reasonably available at the time the TILA disclosure is made (the $2,100 amount in this example), or (ii) amounts shown on GFE plus 10% ($2,200 in this example) even though Regulation X may require any revised GFE to disclose a lower amount.

All-In APR:

The Board is proposing an All-In APR system by entirely revising the calculation of the finance charge and annual percentage rate (APR) so that they capture most fees and costs paid by consumers in connection with the credit transaction. The Board would achieve most of the changes to finance charge calculations by providing a special rule under new § 226.4(g) where the exclusions from the finance charge enumerated in §§ 226.4(a)(2) are inapplicable to closed end credit transactions secured by real property or a dwelling (except that the exclusions in § 226.4(c)(2) for late, over limit, delinquency, default, and similar fees, § 226.4(c)(5) for seller's points, and § 226.4(d)(2) for property and liability insurance would continue to apply to such transactions).

Under the proposal, the following (currently excluded) fees would be included in the finance charge for closed-end credit transactions secured by real property or a dwelling: closing agent charges; fees for title examination, abstract of title, title insurance, property survey, and similar purposes; fees for preparing loan-related documents, such as deeds, mortgages, and reconveyance or settlement documents; notary and credit-report fees; property appraisal fees or fees for inspections to assess the value or condition of the property if the service is performed prior to closing, including fees related to pest-infestation or flood hazard determinations; and amounts required to be paid into escrow or trustee accounts if the amounts would not otherwise be included in the finance charge.

ABA thanks the Board for this bold initiative to simplify the TILA disclosures, and to make it more understandable to all. Although ABA is supportive of all proposals that aim to streamline APR and finance charge calculations, and although we have supported related positions in the past, we oppose the Board's proposal to enact an all-inclusive finance charge system. ABA believes that this proposal will lead to entirely unpredictable expansions in high-cost law coverage. Preliminary analysis by our members of their originations and portfolios suggest that this change would subject an unacceptable level of loans to cross into—(i) "higher priced mortgage loan" segments, (ii) "higher cost" segments, and (iii) numerous state law thresholds that define their own "high cost" provisions in some combination of TILA APR and state-defined triggers.

1. Effects on Loan Triggers:

ABA is in theoretical agreement with the Board's statements in the preamble that the existing APR composition is not entirely helpful to consumers that are shopping for a mortgage loan. The inadequacies of APR in reflecting the actual cost of the mortgage credit transaction are, by now, well documented. The problem with improving the APR figure through redefinitions, however, is that the APR concept has been adopted under numerous legal provisions, particularly at the state level, as a tool to delineate and define the applicability of consumer protection laws and liabilities. This propagation of the use of the APR figure would, under the proposed redefinition of finance charge, dramatically increase the number of loans that trip over the "high priced" or "higher cost" triggers. In most jurisdictions, legislatures have set state thresholds with the assumption that many fees—appraisal fees, title costs, etc.—would always be excluded from finance charge and APR. These state thresholds were therefore set far lower than the TILA-defined federal threshold.

This state-level adoption of APR-based triggers means that, if this proposal were enacted, there would be a dramatic expansion of "high cost loan" liability into prime lending spheres. We remind the Board that banks generally do not make high cost loans (Section 32) under state or federal thresholds, and are currently analyzing how to minimize exposure to "higher priced" mortgage loan compliance obligations (Section 35). We fear, therefore, that the proposed definitional expansions will lower thresholds to a point where diminution of credit will be very significant. The potential effects of this expansion could be so injurious to bank mortgage lending, that we urge that the Board not finalize this portion of the rule without further analysis.

In light of the above, ABA respectfully differs from the Board's statement that the proposed rule would overlap with state laws only "indirectly" by virtue of the all-in finance approach. We believe the overlap is head-on and direct, and changes in one will lead to immediate effects on the other.

ABA appreciates the Board's data analysis, set forth on page 43244 of the preamble, where the Board studies the potential consequence of a more inclusive fee test under upon federal and state law thresholds. In the preamble, the Board finds that coverage of such laws will expand under the proposed rule, but that the expansion of coverage is so slight (2.5% increase in Washington, DC, 4% increase in Illinois, and 0% increase in Maryland) that the Board believes that the proposal would, on balance, still be in the consumers' interest.

ABA believes that these comparisons are preliminarily useful, and they provide some initial insight into potential impact across different states. We think, however, that the preamble's impact analysis is only a start, and lacks the thoroughness required to make a proper determination on whether to advance to a final rule. The Board's informal examination uses survey data that may or may not be complete, and limits the analysis to hypothetical transactions regarding properties valued at $200,000. We believe this is insufficient given the magnitude of the proposed rule's effects. ABA supports a full empirical analysis on this important issue, and we stand ready to assist the Board in perfecting and supplementing a study that considers impact to the full market in terms of finalizing this rule proposal.

2. Legal Authority:

ABA has further concerns regarding the uncertainty of the Board's legal authority to alter the "some-in, some-out" system that is currently codified into the TIL legislation. Although the Board assures that it has carefully analyzed this authority under Section 105(a) of TILA, and that it finds sufficient authority to support this rulemaking, we note that trumping TILA's system of exclusions and inclusions is of central significance to the statutory scheme. Indeed, throughout the last several decades, Congress has carefully and purposefully tailored the concept of "finance charge" by specific designations inscribed into the code. Whether these designations are wise or not, they were specifically chosen by Congress as the factors that compose the TILA disclosures. We note here that the Board's proposed formula would still exclude certain fees associated with mortgage transactions, which means the proposal relies on the exemption authority only insofar as it disagrees with certain particular fee exclusions that congress wrote into law.

We express much concern, therefore, about the Board's extraordinary decision to exempt all "closed end" mortgages from the explicit formulas provided by Congress, and to replace them with what amounts to a different "some-in, some-out" formula that the Board believes is preferable. This is especially significant since the Board has, in the past, formally proposed this general approach to Congress, and Congress has explicitly refrained from advancing on such recommendations.

A central reason for our request that the Board advance judiciously in this area is not that ABA finds the proposal's policy objectionable, but rather that, should this portion of the proposal be finalized, it would be extremely disruptive to test the legal framework of this regulatory change under judicial challenges that are likely to arise. ABA fears that lawsuits by negatively affected parties would focus on this portion of the regulation, and the entire regulatory structure affecting mortgage lending might then be placed in suspension, to the detriment of lenders and consumers alike.

ABA Recommendations:

Should the Board advance in finalizing this proposal, ABA requests that it take into consideration that an "all-in" finance charge system would make creditors fully liable for charges that they do not control. Avoiding this circumstance was certainly part of the logic for creating "exclusions" from the finance charge calculation, and it would be patently unfair to punish lenders for fees that are imposed and retained by third-party players. If, however, such a change is finalized, we ask that the Board consider increasing the current finance charge and APR tolerances to accommodate the possible fluctuations in pricing that occur outside of the lenders control. ABA recommends that a feasible tolerance for an "all-in" regime would be, at minimum, *0.125%* for first fixed mortgages, and *.250%* for ARMs, and that it be linked to an appropriate inflation index, to avoid the need for re-proposals to make necessary adjustments going forward.

A further recommendation, should the Board advance with this proposal, is to alter the Average Prime Offer Rate (APOR) index that the Board is using to define the "higher priced mortgage loan" segments. Since the APOR index is a composite of interest rates and points (as set forth by Freddie Mac's Primary Mortgage Market Survey), it does not follow APR very precisely, and would certainly not follow the proposed "all-in" formula in any meaningful way. The Board should, therefore, alter that index to ensure that it captures all the costs that this proposal would include in the finance charge figure.

Finally, ABA asks that the Board seriously consider the notion of selecting a general 10% fee tolerance for all (or most) finance charge items. This 10% figure is, of course, based on the now-final HUD rule issued in 2008 to amend Regulation X (*See* 73 FR 68204). Adopting this 10% tolerance limit would offer excellent protection for consumers, with conceivably better and more strictly defined ranges than those provided under current rules. In addition, this formulation would greatly alleviate compliance burdens for lenders, by aligning all cost monitoring at settlement to a single 10% standard. It would also achieve fully coordinated direction on when "re-disclosures" must occur under the recent MDIA and RESPA changes. We note that it would be possible to structure this tolerance as a "safe harbor" option under TILA, where any creditor that is subject to RESPA could "opt" to abide by the 10% tolerance rules set forth by Regulation X, and compliance under that rule would be deemed compliance for Regulation Z purposes.

APR-APOR Graph:

The Board proposes that creditors provide a graph that would show consumers how their APR compares to the APRs for borrowers with excellent credit and for borrowers with impaired credit. Under this requirement, lenders must disclose APR in 16-point font in close proximity to a graph that compares the consumer's APR to the HOEPA average prime offer rate for borrowers with excellent credit and the HOEPA threshold for higher priced loans.

For various reasons, ABA believes the Board must engage in further consideration of various elements of this proposal.

As a first item, ABA notes that the text contained in the disclosure of the proposed "Annual Percentage Rate" box is somewhat misleading. The example provided in H-19(H) would make the statement that "For this loan, a 1% reduction in the APR could save you an average of $133 each month." This statement, however, is not entirely accurate. It is true that a 1% reduction in the rate would allow the savings stated, but it is not necessarily true that a 1% reduction in APR would do the same. If the APR reduction results from items other than interest rate, then the monthly savings would certainly differ.

A second element entails concerns regarding cost. We note that in terms of disclosure formats, the graph is the most difficult and expensive design to set up. The systems required to establish accurate graphs (or other spacial representations) that must be tailored to each transaction are more complex, more expensive, and therefore present the most expensive of all alternatives.

In this vein, ABA questions the overall utility of this disclosure, as it is not likely to be as meaningful as the Board describes in the proposal's preamble. At the time of application, interest rate disclosures tend to be preliminary and subject to some adjustment. Under this proposal, the preliminary interest rate figure is used to set up a relationship with high cost loan levels applicable in the market at that time. At that point, however, it is practically impossible for consumers to change or affect the credit score they have, or other element that may affect their loan price. Moreover, the text accompanying this figure makes it appear as if the credit history element is the only item affecting the interest rate disclosed. This is inaccurate. APR levels are composed of many different factors, including non-interest costs, type of loan selected, term, etc. The comparison set up by the Board may be moderately helpful, but it is not one that can be used to arrive to any solid conclusions regarding that specific loan.

This issue of utility is concerning because of the role that the proposed rule appears to apportion to it. In the preamble, the Board appears to acknowledge the above by stating that "[i]n some instances the APR graph may be potentially confusing," and adding that "a loan may be a higher-priced loan for reasons other than the borrower's credit history." Page 43297. ABA appreciates this statement, and respectfully disagrees with the Board's further statement that such confusion could be cleared up by simply "answering consumers' questions." The more likely result at this point of the process is, once again, consumer annoyance, and worse, suspicion that the rate has not been fairly determined. Rather than opting for concise explanations on why the discrepancy in the price levels occurs, the proposed rule elects to go with a system whereby the lender will have to offer explanations regarding disclosed figures that are not necessarily comparable. This discussion is one that is better had outside the context of loan-specific disclosures. It is not entirely reasonable to thrust the loan officer into a role of educator and teacher of credit pricing. Such broader education may be commendable, but it does not belong at the loan application stage, where the cost comparison analysis is entirely distinct from the Board's intended didactic process.

In addition, placing the officer into an educator's role is awkward in terms of policy. Generally, the principle behind a mandated disclosure is that the regulated entity is not entirely trusted to convey the information contained in the mandated form. The disclosure is therefore used as the tool to convey the precise information required to protect or inform the consumer, with no distortion or bias from the party in a position to gain from the disinformation. This principle is violated by providing a disclosure that is intended to elicit explanations from the loan originator. In this sense, the proposed arrangement could place unsophisticated consumers in a vulnerable position.

The problematic element of this proposal, therefore, is that the forms set forth imprecise comparisons in the hopes that it will elicit questions from the consumer. The inaccuracy then serves an apparent goal of shifting the role of "informing" the applicant from the TILA disclosures, where it belongs by law, to the lender, where it is not appropriately placed. Under this proposal, TILA's laudable objective of educating consumers about the proper use of credit becomes distorted.

ABA's Recommendation:

We urge the board to consider alternative approaches, but that it do so under the FACTA risk-based pricing regulations (73 FR 28966), and that the relationships and comparisons of APOR to APR be explained and made clear in those disclosures. That regulatory provision is intended to guide consumers when the creditor grants or extends credit to the consumer on terms that are "materially less favorable than the most favorable terms available to a substantial proportion of consumers." The issues underlying the FACTA rulemaking appear to be the precise issues that are driving the Board in this portion of the form under proposal. Congress plainly intended that FACTA be the primary tool for consumer instruction on this subject matter, and such intention should be observed.

<u>Disclosures Three Days before Consummation</u>

The proposal would amend Section 226.19(a) to require that creditors provide a "final" TILA disclosure that the consumer must receive at least three business days before consummation, even if no terms have changed since the early TILA disclosure was provided. Under this proposal, the Board would require creditors to finalize and confirm settlement costs <u>earlier</u> than RESPA does—at least three business days before consummation.

In addition, the Board is offering alternatives in instances where terms change after the "final" TILA disclosures are provided. Under one option consumer would have to receive amended cost disclosures at least three business days before consummation. Under another option, re-disclosures would be provided at least three business days before consummation where certain tolerances are exceeded.

ABA's comments on this portion of the proposal are premised upon, and heavily shaped by, the interplay of TILA and RESPA disclosures and tolerance rules. ABA member banks do not have the comfort of being able to separate one rulemaking from another as the massive RESPA reforms are being thrust upon our industry at the same time as these rules are being proposed, and simultaneously with our other efforts to come into compliance with the Board's recent changes to Section 32/35. In order to streamline our comments and recommendations, this section of our commentary will also address the following Board proposals—

- Requiring disclosure of potential changes to the interest rate and monthly payment.
- Disclosing total settlement charges, as currently required for the Good Faith Estimate (GFE) under RESPA.

- Summarizing key loan features, including the loan term, amount, type, maximum amount of prepayment penalty, and others.
- Adopting new format requirements, including rules regarding: type size and use of boldface for certain terms, placement of information, and highlighting certain information in a tabular format.

ABA highlights the Board's various statements in the proposed rule's preamble, recognizing that HUD has issued extensive rules and guidances regarding the Good Faith Estimate and HUD–1 Settlement Statement, as well as policy statements regarding creditor payments to mortgage brokers under RESPA. The preamble clarifies that, in light of all such rules and issuances that pertain to the very same issues that are addressed in this rulemaking, the Board's intentions are that the current proposed rule is meant to complement HUD's rulemakings and pronouncements on the common provisions addressed under Regulation X.

ABA appreciates the Board's work in achieving rules that are complimentary with RESPA. However, since TILA and RESPA address the same exact costs and fees through different viewpoints, even the most sincere attempt to unilaterally harmonize this disclosure system will lead to replications, overlaps and jumbled mixtures of forms that consumers will find obscure and undecipherable. Unless the agencies work together to ensure that the presentation of the disclosures are fully consistent, and most importantly, integrated, the objective of clarity will not be achieved.

We note, for instance, that the Board tested the current proposed disclosures to ensure that they provide consumers with the full range of information needed in order to shop for mortgage loans. This is commendable, but it misses the point that HUD is attempting to achieve the same exact thing through its own RESPA disclosures. In the recent rules finalized in November 2008, HUD extends its disclosure mandates to ensure, not only a complete list of settlement costs (as mandated by RESPA), but also a full listing of interest rate-related information that are mandated under TILA disclosures. The laudable attempt by the two agencies to provide the optimal disclosure for the full range of shopping elements involved in mortgage transactions nonetheless goes astray by creating onerous repetitions that are set forth in differing forms, contexts, and formats. Even if both disclosures are technically correct, they cause a mismatch in presentation and terminology that only create confusion for the average credit consumer. The findings presented on page 43234 of the preamble, that "consumer testing conducted by the Board found that consumers wanted to have settlement charges disclosed on the TILA form" does not address the fact that those costs are already presented in another HUD form, and the information is fully available to them without any further requirement to add more disclosure boxes under Regulation Z.

In addition, the attempt to "compliment" HUD disclosure items does not account for the tricky timing requirements of *when* the disclosures must actually be presented to the consumer. The interplay between proposed § 226.19(a)(2)(ii) and § 226.38(a)(4) are a good example. In the preamble, at page 43260, the Board states that its proposal "would require creditors to finalize settlement costs earlier than RESPA does." The Board here accepts that "requiring that loan terms and costs be finalized several days before consummation would require significant changes to current settlement practices." Indeed, these proposals brightly highlight the extremely problematic implementation and compliance issues involved. The Board's proposal will, in effect, alter the RESPA disclosure scheme because of its decision to use the disclosures of Regulation X to present information in the TILA forms. In short, the Board is overriding HUD's own construction of timing because it believes information is best presented through a different form. Although we support full consumer understanding, we view this decision to override a sister agency as somewhat irregular with a legislatively mandated system that apportions responsibilities for different disclosures to different agencies.

ABA's Recommendations:

We urge that the agencies refrain from competing with each other's disclosures, as this can only lead to excessive overlaps and mounds of paper that overwhelm any incentive by the borrower to study and understand these complex forms. They also lead to augmented costs for lenders, and amplified liability threats that are not justified by any added benefits to consumer understanding.

If the Board determines to finalize this aspect of the proposed rule, ABA offers the following comments and recommendations—

- *Initial Disclosures*: With respect to the initial disclosures proposed by the Board, the current portion of the Regulation Z proposals that aim to add disclosures of total settlement charges, summaries of key loan features, and other details, are express repetitions of recently added disclosure items of the RESPA regulations. These provisions, especially those under § 226.38(a)(4), are repetitive, not just "complimentary," and will layer redundant information that is mirrored under other regulatory provisions.

- *Disclosures Prior to Consummation*: As it pertains to disclosures prior to consummation, proposed § 226.38(j)(1) should provide that the HUD-1 settlement statement is a permissible substitute for the itemization of amount financed, and the Board should refrain from adding any further requirement that this portion of the disclosure be received at least three business days prior to consummation (as set forth in § 226.19(a)(2)). We believe the Board is provided with sufficient authority to enact this simpler substituting option, and it would not cause any impairment to consumer understanding. The new MDIA timing, accuracy, and settlement delay requirements would protect the consumer against any major cost departure from the initial disclosures. The Board's stated "long-standing concerns that consumers fac[e] different loan terms or increased settlement costs at closing" would still be well addressed under now-active MDIA rules. The consumer would also be sheltered from such increases by virtue of the recent HUD rules that apply tight tolerances in the different fees applicable to settlement. Further, this arrangement of citing to, but not mandating the reproduction of, the HUD-1 settlement statement would properly avoid the head-on collision with RESPA's statutory requirements. Lenders would also enjoy increased regulatory certainty and less paper work, and consumers would, we believe, be spared from disclosures.

- *Re-Disclosures*: With regard to the two options presented by the Board on the proposal to require the creditor to provide a final TILA disclosure that consumers must receive at least three business days before consummation (even if no terms have changed since the early TILA disclosure), ABA believes that the second option is the superior choice. Under this option, creditors would be required to provide another final TILA disclosure, but would have to wait an additional three business days before consummation only if the APR exceeds a designated tolerance or the creditor adds an adjustable-rate feature. Should the Board decide to finalize the "all-in" finance charge proposal, ABA would stress the need to amend the finance charge tolerance to a higher level, to accommodate the additional elements that are included in that calculation. ABA recommends that a feasible tolerance for an "all-in" regime would be, at minimum, *0.125% for first fixed mortgages, and .250% for ARMs*, and that it be linked to an appropriate inflation index, to avoid constant adjustments going forward.

- *Waiver of Waiting Period*: Whether or not the Board adopts this second option, ABA requests that the Board provide further clarity on the propriety of "waiting period" waivers that would allow consummation to occur during the seven-business-day waiting period required by § 226.19(a)(2)(i), and those applicable to three business days before consummation in proposed § 226.19(a)(2)(ii), in the event of a *bona fide* personal financial emergency. We believe that it would be entirely consistent with TILA's statutory mandate if the Board created a rule providing that whether a personal financial emergency has been met is to be determined by the facts of the situation, and that consumers should determine whether an emergency exists under their specific circumstances. In this sense, ABA requests that the Board clarify that creditors are entitled to rely on a borrower's assertion of what constitutes a "bona fide personal emergency," and that there be no second-guessing by a lender of whether a bona fide emergency exists once a consumer asserts the need to expedite the transaction based on allowable exigencies. As a corollary, lenders should be afforded, at minimum, a presumption that this standard has been met if there is a good faith reliance on the borrower's declaration of a bona fide emergency.

  ABA believes that a more relaxed application of the waiting period waiver rules would be of much benefit to consumers that are in dire financial straits, but do not qualify under the single limited instance provided under current § 226.19(a). So long as the consumer can assert and attest to exigent circumstances, the lender should be able to safely accommodate any urgent need. There is no justification to block workable solutions when all the parties in the transaction are in agreement and able to perform as necessary to avoid (or cure) urgent situations.

In summary, ABA respectfully requests that this portion of the rulemaking be finalized only upon full consultation and harmonization of the proposal with HUD. We urge that the timing requirements be exactly synchronized, and that the disclosures not be duplicated.

Disclosures After Consummation

The Board's proposals would seek to change the timing, content and types of notices provided after consummation in various ways.

Advance Notice of Payment Change:

The Board is first proposing a change regarding ARM loans, increasing the advance notice of a payment change from 25 to 60 days, and revising the format and content of the ARM interest rate adjustment notice.

ABA has various observations on this item, listed as follows:

- ABA members do not believe that a 60-day advance notice period is feasible for government-backed loans, certain ARM products, and other programs that are often held in portfolios by banks. In many such instances, it is impossible to provide accurate notice that far ahead of time because the necessary indices are simply unavailable.

- In addition, the inclusion of unpaid principal balance in ARM reset notices, as set forth in the proposed H-4(G) tables, is not customary today. This proposal constitutes a departure and a burden because ARM reset notices are based on projected balance, and therefore, the 60-day advance figure presented to the borrower may differ from that which appears in the statement. This discrepancy is certain to result in confusion for consumers. We suggest that the Board consider revising the language of the disclosure to indicate that the new loan balance, as of the adjustment date, is projected to be a specific amount.

- The notices applicable under current regulations do not break out principal and interest into separate items. Since the amounts allocated to principal and interest change each month, the result is that, on amortizing loans, such figures would be accurate for one month only. In addition, the borrower already receives this information on their monthly billing statement, where the information is timely and accurate.

- We note that ARM resets and T&I escrow analysis are separate and entirely unrelated processes. Therefore, disclosing T&I in the reset notice will lead to confusion, as the payment amounts are very likely to vary due to changes imposed by the taxing authority, or the insurer, when the escrow analysis is undertaken (or as otherwise needed to recoup shortages or corporate advances).

- Under the proposal, the customer could feasibly have two regular payments due after receiving the proposed Notice of Change, and prior to a change in the payment amount taking effect. Such a scenario will surely cause confusion, as the borrower is either over-paying for two months (if the payment was decreasing) or underpaying (if the payment was increasing) because the borrower is likely to not recall a notice sent 60 days prior to the rate change. In the latter instance, the consumer would be assessed a late charge.

- The proposed forms do not reflect optional payments, such as credit insurance, that may apply to a loan. ABA requests guidance on how these items should be treated and disclosed.

- An important ABA concern with this proposal is that the advance notice requirement is likely to have an extremely negative impact on construction loans. The unintended consequence could be particularly acute on construction loans of 12 months duration, where rate-change cycles are vital to controlling lender risk. Under current rules, the loan rate can be adjusted to reflect monthly rate changes; under the Board's proposal, the 60-day advance notice requirement would force a 60-day lock-down on interest adjustments. We fear that many lenders will stop offering construction loans where the credit risk compels monthly adjustment of interest. Such a result would be of little benefit to anyone, as these notices provide no consumer benefit in the context of construction loans. In short, the central protective goal of these notices is that borrowers be afforded sufficient time to refinance before payments increase; this objective is irrelevant in constructions loan circumstances because it is highly unlikely that the borrower would be able to refinance a construction or "bridge" loan prior to completion of the construction or the sale of the house. ABA therefore requests that the Board add an express exception for construction loans.

- A further burden with the proposal centers upon the prepayment penalty disclosure provision. Under proposed § 226.20(c)(4)(i), the Board provides that the creditor shall disclose the maximum prepayment penalty possible if the consumer prepays in full between the date the creditor delivers or mails the ARM adjustment notice and the last day the creditor may impose the penalty. The preamble discussion on this issue does not appear to recognize that prepayment amounts are extremely varied and difficult to calculate in this context. There are large varieties of circumstances under which prepayment fees may be charged, including refinance only, refinances with different creditors, or only upon the sale of the property. These varied circumstances are not properly captured in the Board's proposed disclosure text. In addition, there are various ways to calculate the actual prepay fee—percentage of outstanding principal balance, number of months' interest on the amount prepaid, difference between current rate and market rate. The diversity of conditions that exist across lenders and across markets make it extremely difficult, if not impossible, to fit into one descriptive sentence, as proposed in the rule. For such a form to have any accuracy would require the assumption of certain facts at particular points in time, which means having access to information that is accurate and in effect before the notice is prepared. The problem is that such assumptions are likely to change very quickly, leaving consumers with entirely inaccurate forms.

- ABA requests that the Board clarify in any final rule, that servicers may combine the adjustment notices with other disclosures that are required by RESPA, the Homeowner's Protection Act, or other applicable law, unless expressly prohibited.

Periodic Statement for Negative Amortization Loans:

The Board is proposing, for loans with negative amortization, that there be a requirement for a monthly statement to provide information about payment options that include the costs and effects of negatively-amortizing payments. Under this rule, creditors would be required to provide, not later than 15 days before a periodic payment is due, a periodic statement for payment option loans that have negative amortization. The disclosure would contain a table with a comparison of the amount and impact on the loan balance, and property equity of a fully amortizing payment, interest-only payment, and minimum negatively amortizing payment.

ABA has various observations on this item, listed as follows:

- ABA is concerned that the proposed form will not serve to fully educate borrowers about their options. We note that the proposed negative amortization notice is a simplification of a very complex product, and could potentially lead the consumer to a level of confusion that outweighs any potential clarity provided by the form. For example, the proposed form assumes that the minimum payment only covers part of what may be owed. This may be true for some option ARM products, but not for all. Moreover, in a falling rate environment, the minimum payment can result in over-amortization, with the borrower putting more toward principal than they would under an amortizing payment. ABA further notes that the disclosure of the fully amortizing payment could also create confusion because, once the loan is in negative amortization mode, all capitalized interest must be paid before any borrower payment is applied to actual principal.

- The proposed 15-day advance notice requirement is contrary to the "bill and receipt" servicing convention where statements are ordinarily sent only after the payment is actually received. Therefore, under this proposal, those borrowers that do not pay on time, or those that pay at the last minute, would receive inaccurate disclosure information.

- Should the Board advance with this proposal, we ask that there be consideration of not applying this rule to any loan made prior to the effective date of the regulation. As noted by the Board, the industry is currently operating pursuant to samples and principles issued under the Interagency Guidance on Nontraditional Mortgage Products, and those guidelines should suffice for existing loans. As expressed by the Board in the preamble, the proposed model table is similar to the summary table the agencies issued under the Interagency Guidance, with some slight revisions based on consumer testing. To simplify and minimize system changes, we ask that the Board provide that all servicer systems that relied on that Interagency Guidance to establish their procedures are within legal requirements, and any new rules should therefore apply on a prospective basis.

Creditor-Placed Property Insurance:

For creditor-placed property insurance, the Board is proposing to require notice of the cost and coverage of such insurance at least 45 days before imposing a charge for the insurance.

The Board's observation that creditors "are not currently required under Regulation Z to provide notice before charging for creditor placed property insurance" is a technically accurate statement, but it does not recognize the reality that customer notification prior to force placement is a widespread practice today. Indeed, the creditor-placed property insurance rules being proposed by the Board are generally consistent with the way major servicers are dealing with insurance lapses today. However, ABA is concerned with this proposal, as it seeks to reduce to strict regulatory requirements practices that constitute broadly accepted industry norms; thus imposing yet additional compliance obligations and, of course, the concomitant potential for liability. The proposed amendment establishes three conditions for charging for creditor-placed insurance, imposing unique timing and "day counting" requirements that create liability traps for lenders.

The myriad questions about notice and timing that have arisen with respect to a lender's obligation to force-place flood insurance underscore the need for clarity. As the Board is aware, recent interagency efforts to provide guidance to banks on their rights and obligations with respect to the force placement of flood insurance has engendered much confusion for the industry. Questions abound as to when a notice may be sent to a borrower, when a bank may force-place insurance, and whether a bank may charge the borrower for the cost of force placed insurance. What appears to be a relatively straightforward compliance obligation for banks has been turned into a complex web of questions. ABA urges the Board to avoid a similar result and to ensure that any regulatory obligations adopted here are consistent with the guidance provided to banks with respect to the force placement of flood insurance.

Finally, ABA fears that the proposed approach may have the unintended effect of encouraging borrowers to delay 45 days before fulfilling their obligations to maintain the required insurance. The proposed timing scheme, coupled with rigid disclosure language, is in stark contrast to the current approach of communicating with the consumer early, and then conveying an increasing sense of urgency with each letter, in order to encourage the borrower to act quickly. The latter approach has proven effective in actual practice, and there appears to be little evidence that it needs to be altered.

Loan Originator Compensation

The Board is proposing very far-reaching limits on originator compensation. The proposed changes include prohibiting certain payments to a mortgage broker or a loan officer that are based on the loan's terms and conditions, prohibitions on compensating the broker where they have received any other payment from any other party in connection with that transaction, and prohibiting a mortgage broker or loan officer from "steering" consumers to transactions that are not in their interest in order to increase the mortgage broker's or loan officer's compensation.

ABA is in general agreement with the need to ensure that consumers are well protected when they deal with mortgage brokers. ABA believes that the Board is justified in its stated concerns that yield spread premiums can create financial incentives and that they may be used to steer consumers to riskier loans, solely to achieve greater broker compensation. It is also true that in such instances, consumers may not be aware of the loan originators' conflict of interest and may not be adequately informed to protect themselves against abuse.

The Board must, however, take extreme care in crafting over-broad and overly restrictive rules in this area. It is well documented that yield spread premiums can provide benefits to consumers, especially those in hard-to-reach communities. Moreover, this compensation methodology has been a useful tool in finance because consumers do not have to pay cash fees or compensation, thereby surmounting the largest obstacle in most home financings. The Board's arguments in the preamble (page 43282), that potential injury from YSP compensation is not outweighed by its potential benefits is highly questionable, and the weights apportioned to the benefits and burdens discussed by the Board are not consistent with certain industry and other views.

ABA has some reservation, therefore, regarding the need to enact "unfair and deceptive" provisions to cover origination compensation arrangements. The Board is not only entering an area where the research regarding the appropriateness of specific compensation schemes is somewhat confused and inconclusive, but it is also treading into a regulatory field that has, up to this point, been entirely dominated by HUD rulemaking under RESPA. As the Board states in page 43281 of the preamble, "HUD recently adopted disclosures in Regulation X, implementing RESPA, that could enhance some consumers' understanding of mortgage broker compensation, the details of the compensation arrangements are complex and the disclosures are limited."

Through the issuance of this proposal, the Board is in effect opining that it does not deem these new RESPA provisions to be sufficiently protective, and is therefore opting to enact further restrictions regarding compensation. We urge care in this endeavor because, as mentioned above, the Board would again be competing against a sister agency's (HUD) own determinations and regulatory decisions on an issue of very delicate policy considerations. Once again, the indiscriminate piling on of rules on similar activities and comparable transactions presents a clear danger of inadvertently amassing arbitrary legal risks in unpredictable combinations.

Nor is RESPA the sole regulation that must be considered when enacting these far-reaching restrictions. Before advancing, we urge that the Board take full measure of the actual need for this new proposal by analyzing the full range of other numerous, recently-enacted provisions in this area, and assessing their success once they have had a chance to work. We note, for instance, that in July 2008, we saw the enactment of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act, 12 U.S.C. 5101–5116), intended by Congress to create a Nationwide Mortgage Licensing System and Registry of loan originators to increase uniformity, reduce fraud and enhance consumer protection. This system is intended to ensure the integrity of brokers and loan officers nation-wide, and provide consumers with easily accessible information to research a loan originator's history of employment and any disciplinary or enforcement actions against that person. In addition, through the MDIA and the final implementing rules, all originators will be required to provide early, transaction-specific disclosures for mortgage loans secured by dwellings, and will even impose waiting periods between the time when disclosures are given and consummation of the transaction. (See 74 FR 23289). These are novel and far-reaching provisions that have not been given any opportunity to function. Together, RESPA, SAFE and MDIA provide an extremely tight set of protections that will go a long way in securing consumers against unfair originator activity.

It is somewhat difficult to understand why the Board appears to entirely overlook the sure impact of these new provisions through a current proposed rulemaking that adds yet more law to this area. The Board's descriptions regarding the need for the adoption of an "unfair and deceptive" standard for originator compensation fail to properly account for the new rules and standards enacted in the past 18 months. The section in the preamble section entitled "*Injury not reasonably avoidable*" (see page 43282) speaks to the complexity of YSP compensation arrangements, confusion about who the broker represents, and lack of transparency. All of these issues are important, and they are meaningfully addressed in part through the provisions of SAFE, MDIA, and the new RESPA rules. They are also addressed though some other disclosures being proposed in this rulemaking. We urge that the Board engage in a full inventory of existing law, and weigh the full protective effects of these numerous new provisions before finalizing this very burdensome provision.

In addition, this proposed rulemaking is stretching the Board's TILA authority to reach compensation to loan officers. ABA disagrees with the Board's decision to intrude in business compensation decisions, and finds this action to be entirely unsupported by the proposed rule's findings. In the preamble's background section (page 43279), the Board goes to great lengths to describe the harms that it believes permeate the market to the point where additional regulation is needed and justified. In that detailed discussion, the Board focuses its consideration on mortgage broker activity, and consumer confusion and susceptibility to such third party, non-bank originators. Notably, the Board does not in any way identify any history of abuse, nor any significant finding of consumer confusion, related to the use of banks as mortgage originators. It is extremely troublesome, therefore, that the Board moves on to craft a proposal that universally covers all originators, when bank "loan officers" are not at all present as the identified culprits of the harm.

ABA will not fully expound here the wide differences that exist between mortgage brokers and banks; these differences are laid out in a wide array of industry and consumer literature. We must point out, however, that the ample variances in regulation and oversight, the constant oversight by examiners, the fact that banks place significant amounts of capital on the line, the reality that reputational impact is paramount for banking business, all these and more, are open and very evident factors that make banking institutions more cautious and attentive to safe lending practices, and less likely to be the source of the abuse and fraud that the Board describes in the preamble. ABA is therefore dismayed that the Board's proposed rule completely ignores these obvious market segmentations and imposes overly-broad prohibitions that in effect, treat every single player in the market as unregulated, unsupervised, and non-capitalized operators.

It is by now widely understood that the examples of abuse that occurred over the past several years originated primarily in the unregulated or less regulated non-bank sectors. Members of Congress from both parties have noted that, to the extent that the system did work, it is because of prudential regulation and oversight of banking firms. While improvements within the banking regulatory process can certainly be made, the most pressing need has been to close the regulatory gaps <u>outside</u> the banking industry through better supervision and regulation – both on the consumer protection and safety and soundness sides of the coin.

ABA Recommendations:

In light of all this, ABA strongly urges that the Board reconsider this entire aspect of the proposal regarding LO compensation agreements. At minimum, the Board must resist impulsive calls for new and untested rules, and wait until—(1) HUD's new RESPA rules are implemented and allowed to work, (2) the MDIA protections gain full effect, and (3) SAFE Act measure are fully incorporated into practice. Before disturbing long-tested compensation schemes for loan officers, the Board must carefully gauge the purpose and effect of these newly enacted provisions, especially in how they apply to banking institutions that have had no history of consumer abuse.

Should, however, the Board decide to advance with final rulemaking in this area, ABA would urge consideration of the following elements, to ensure a more sound regulatory scheme—

- *Loan Originator Definition:* Under the Board's proposal, the term "loan originator" is defined as a person "who for compensation or other monetary gain, or in expectation of compensation or other monetary gain, arranges, negotiates, or otherwise obtains an extension of consumer credit for another person." The proposed definitions clarifies that the term "includes employees of the creditor." § 226.36(a).

  ABA requests that the Board refine this definition of "loan originator" to ensure that it excludes individuals who are managers and supervisors, and whose compensation is not based upon loans that they directly originate, but on the production of the individuals they manage and supervise. Such managers and supervisors have little actual impact on an individual loan, and should therefore be excluded.

In addition, under the proposal, a "loan originator" would include employees of creditors who perform loan origination "functions." The definition should ensure that it is not overinclusive, and explicitly provide that purely administrative employees that only assist loan originators are not included in the proposed rule's purview.

ABA recommends that the Board consider adopting the definition of originator that is provided under the *Secure And Fair Enforcement For Mortgage Licensing Act* (SAFE Act), covering licensing and registration requirements for mortgage brokers and loan originators. Under the SAFE Act approach, a mortgage loan originator would be defined as an individual who takes a residential mortgage loan application <u>and</u> offers or negotiates terms of a residential mortgage loan for compensation or gain. The definition explicitly excludes "an individual who performs purely administrative or clerical tasks." A residential mortgage loan would be defined as "any loan primarily for personal, family, or household use that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling" and includes reverse mortgages, home equity lines of credit, and other first and second liens. The precise language for the definition of originators is currently being finalized through regulations being crafted by the federal regulatory agencies. (See 74 *FR* 27386-27422). ABA believes that adopting a similar designation for loan originators under this proposal would provide a solid definition for TILA purposes, and would regularize definitional difficulties that mortgage lenders are facing in the ongoing multiplication of rules and regulations covering mortgage lending.

- *Compensation Based On Loan Amount:* The Board is requesting comment on an alternative that would allow loan originator compensation to be based on the loan amount, which would not be considered a transaction term or condition for purposes of the prohibition in § 226.36(d)(1).

  ABA believes that option #2, as set forth on page 43284 of the preamble and specifically stating that loan amount is not a term or condition of the loan, is the better alternative. ABA believes that compensation based on loan amount should be permitted, and is a methodology that has been used to compensate bank employees without resulting in abuse or steering. Any prohibition against the ability to consider loan amount in compensating originators would cause real disruptions in the mortgage broker and bank originator compensation arrangements.

  Similarly, ABA requests that the Board consider allowing lenders to use specific percentage amounts that decrease as the loan amounts increase. A straight percentage based compensation scheme could lead to excessive or disproportional payments, and we ask that creditors retain the ability to impose uniform policies that address this concern.

- *Anti-Steering Provision:* The Board is soliciting comment on its rule to prohibit loan originators from directing or "steering" consumers to loans based on the fact that the originator will receive additional compensation, unless that loan is in the consumer's interest. ABA finds this multi-prong test very complex, and entirely unworkable. It should be noted that, as written, this new rule has at least three different tests that must be met in order to violate its strictures—(1) there must be an affirmative action to steer, (2) based on some added or intensified gain or compensation, and (3) where the consumer does not, in some fashion, benefit.

We note that each of these tests, or prongs, is dangerously loaded with litigation and compliance risk, and such risks have been entirely indomitable in other legal settings. The first prong, dealing with "steering," has been the subject of endless debate and litigation under RESPA's Section 8 "referral fee" analysis. What precisely is the "act" that sufficiently "influences" a person to select one product over another, and become covered under the label of "steering"? There is simply no way to distinguish an act that affirmatively "steers" as opposed to an act that just guides a consumer across various advantageous options that have varying permutations of benefit.

The "additional compensation" factor is also one that has been the subject of countless pages of regulations and legal findings. Since the concept of "compensation," or human gain and benefit can take forms other than pure money transfers, the potential for subterfuge becomes endless. Every single added benefit or bonus offered to an originating employee would become the object of regulatory scrutiny. Baseball games, window offices, promotions, dinners, all would become potential currencies for corruption, and the risk of scrutiny and investigation becomes omnipresent. The intrusion into the employer-employee relationship would become utterly extreme.

The third prong is perhaps the most difficult. It is almost impossible to objectively determine whether a consumer's "interest" is best met when a particular loan is selected. The determination of whether a particular loan was in the consumer's best interest compared to other available loan products involves a full assessment into factors that are simply too numerous to fully list, including the consumer's state in life, his/her future wishes or preferences, appetites for risk, and the basket of loan terms included in the loan product. It also requires an assessment of whether the consumer should seek any credit at all. It may comprise an assessment of whether the applicant has children with special needs, or whether there might be children at all. That such considerations are disallowed by other laws would not stop them from being used as evidence in class action lawsuits.

Nor can the Board ignore that all the tests and criteria described above must be placed into an orderly set of guidelines that allow employees to properly understand their boundaries, and properly understand the level of any relationship they have with the borrower. Such guidelines would also have to impose methods to ensure that institutions are able to properly control for full compliance. This is especially important because the misapplication of these tests and criteria can result in errors or omissions that have serious fair lending implications.

The rigidity that these rules will impose will dramatically affect personal interaction between the borrower and the advisor/originator. In summary, ABA is strongly opposed to the Board's anti-steering provision. Moving towards any such standard will multiply legal risk and seriously alter relationships between bankers and borrowers.

- *Clarify Other Criteria:* ABA requests clarification that compensation to loan originators may be based upon pull-through rates, file quality, customer satisfaction, and communication quality.

- *Concessions:* Under current practice, it is common to allow for the reduction of the loan originator's compensation in order to grant a discount or concession, as long as such concessions are monitored and occur only on an exception basis. The Board should specifically provide for this in any final rule.

Summary

ABA appreciates the Board's efforts to simplify and improve the disclosures for mortgage loan transactions. We are very concerned, however, that various portions of these proposed regulations pose mechanical and other compliance problems that must be properly resolved before advancing to a final rule. Most importantly, we continue to be troubled with the lack of coordination with HUD's disclosure reform efforts under RESPA, which we believe causes a disclosure dissonance that threatens compliance breakdowns and consumer confusion.

We also urge the Board to be mindful of the tremendous compliance burdens that are being thrust upon our industry. Severe burdens are being placed upon banking institutions as authorities pile on more legislative and regulatory provisions on an unrelenting basis. Policymakers must begin to more closely focus on regulatory costs and benefits, and expand efforts to avoid excessive regulatory burden.

Thank you for considering our request. Please contact Rod J. Alba, ABA's Vice President, Mortgage Finance (202-663-5592 or ralba@aba.com) if you have any questions or would like to discuss these issues in greater detail.

Sincerely,

Rod J. Alba